BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 18, 1946

To Chairman Eccles

Subject: Extension of the Price Control Act

From Kenneth B. Williams and
Richard A. Musgrave

It is generally believed that strong pressure will not be brought to eliminate price controls--unless OPA establishes a ceiling on raw cotton, in which case the cotton bloc is likely to insist upon the elimination of all price controls. The people in OPA appear to be well aware of this and hence, are likely to go out of their way to find reasons for not placing a ceiling on cotton.

Major attacks on price controls are expected to come in the form of amendments which will cripple OPA or force it to grant price increases of an inflationary character. Also, an effort will be made to extend the Act for only six months instead of one year as requested by the Administration.

The types of amendments expected to be put forth include such things as:

(1) Requiring OPA to set prices high enough to provide normal profits on every product, regardless of the profit position of the firm as a whole, and to each firm, regardless of how inefficient it is. Such an amendment would force a sharp increase in prices.

(2) Require all wage increases to be offset automatically by equivalent price increases whether or not higher prices are needed to yield adequate profits.

(3) Eliminate the MAP program. This program attempts to encourage the output of lower priced products by requiring textile and apparel companies to distribute their output by price lines in such a way as to result in the same average price as in the base period, usually 1943. Elimination of this program would make it difficult to obtain adequate production of lower priced shirts, suits, etc. As long as producers are able to sell all they can produce of the higher priced goods, they are unlikely to

produce any substantial volume of lower priced goods on which profit margins are necessarily smaller.

(4) Require ceilings on farm products and foods to be set high enough to cover the rise in imputed wages of the 6 or 7 million farm operators and family workers as well as the actual rise in wages paid the 2 million or so hired workers. Such an amendment might increase food prices by as much as 30 or 40 per cent.

(5) Require OPA to allow a flat percentage increase in rents. If accepted, this would be almost certain to touch off additional wage demands.

(6) Establish by law rigid rules as to the timing of the release of specific goods from price controls. This would tend to encourage producers to hold goods off the market as they approached their decontrol dates.

(7) Farm groups are still opposed to subsidies and efforts will probably be made to eliminate food subsidies at the end of this fiscal year. Subsidies authorized for fiscal year 1946 amount to about 600 million dollars for non-food products, mostly in the form of differential payments to obtain high cost output of metals and similar products, and to about 1.8 billion dollars for food products, mostly paid in the form of flat subsidies to all producers. The subsidy program for next year is expected to be reduced greatly in any case, but to eliminate all subsidies would result in sharp advances in the prices of many foods important in the cost of living.

(8) Eliminate the Emergency Court of Appeals. This would be disastrous and open up the possibility of different prices and pricing standards in every court district of the country.

(9) Prohibit OPA from requiring distributors and retailers to absorb part or all of the price increases granted at earlier stages of production. This is aimed at maintaining standard percentage margin mark-ups regardless of the profit situation of distributors. For example, OPA estimates that the nominal prewar dealer margin on new automobiles was 24 per cent. However,

after allowance for price shading, losses on trade-ins, and other expenses, the actual realized margin was only 11½ per cent. Nevertheless, OPA was severely criticized when it forced dealers to reduce their nominal margins on 1946 cars to 21½ per cent even though it seems certain that realized margins will be far above prewar levels because used cars will be a source of profit and there will be no price shading. It also should be noted that fixed percentage margins tend to result in the pyramiding of price increases granted at earlier stages of production.

(10) Special groups of all kinds are expected to ask Congress to give them special price advantages. This would put Congress in the position of determining prices and would tend to increase enormously the political pressure brought to obtain similar advantages for other groups.

(11) OPA may be required to limit price controls to essential commodities and to free from control all luxury or less essential items. This would be disastrous because it would tend to shift manpower and other resources from the production of essential goods to the production of luxuries. The equity of such a policy is completely backwards since it would reward handsomely the producers of nonessential goods and hold down the producers of essential goods. As a consequence, strong pressures would develop to take controls off essential goods also.

OPA policies and administrative actions are more flexible than they are usually given credit for. OPA has already granted a great number of price increases in order to meet higher costs of production or to encourage production of essential goods. However, in some cases where price increases have been granted to obtain increased production, production has not increased.

Also, under the standards laid down by the Office of Economic Stabilization, OPA has the authority to remove or suspend price controls of almost anything. OPA has already decontrolled over 1,300 products having an estimated sales value of around 5½ billion dollars. In general, the products decontrolled have been those in which supplies were fairly adequate, or those unlikely to have significant effect upon the cost of living, or those for which maintenance of controls involves excessive administrative burdens.

The fact is that practically all commodities are pressing hard against their ceilings, either because of the high normal demand or because demand has been increased because of speculative influences. In several cases where price ceilings have been suspended or eliminated, prices have advanced sharply. For example, it is reported that clothes pins went up from 5 cents a dozen to 20 or 25 cents a dozen when controls were taken off. Similar increases, although not so spectacular, occurred in the case of citrus fruit, some furs, coconut, cucumbers, and other products. Whenever one product is decontrolled pressure is intensified to suspend controls on other products.

The rationing issue is largely dead since nothing but sugar is being rationed to consumers.

The Civilian Production Administration still retains most of the powers held by the War Production Board. However, CPA's authority stems from the Second War Powers Act which, like the Price Control Act, expires June 30 unless renewed as recommended. Although the authority is still there, most of the former WPB controls have been eliminated. Only about 60 allocation, limitation, or other orders are still in effect and only 20 or 30 important commodities are still under control. For example, controls are still in effect on rubber, tin, tin can containers, lead, leather, burlap, glass, and some textiles. The military agencies still retain their priorities, but of course they are not being used to the same extent as during the war. CPA uses its authority largely to break bottlenecks when persuasion or other measures fail.

CPA has special priority programs designed to channel materials into low cost housing and low priced garments. If Wyatt's housing program goes through, CPA probably will be forced to reinstate L-41 or something close to it. This would require the allocation of the total supply of building materials and a prohibition against all building except that for which permission has been given. At present, priorities merely provide assistance in obtaining building materials on the basis of individual applications.

On paper CPA has a general inventory regulation which covers practically everything. Not much use has been made of this regulation, but CPA is getting ready now to implement the regulation so as to break up the apparent hoarding of shirts, shorts, nylons, men's clothing, and other textiles. If the situation requires it, CPA may also establish stronger controls in other fields and institute compliance actions.

Attached is a copy of material on price control submitted by Chester Bowles to the Senate Small Business Committee in early December. This gives an excellent factual background of the problem and the policies followed by OPA

February 18, 1946

Chairman Eccles

Material for OPA Testimony

Richard A. Musgrave and
Kenneth B. Williams

Attached is a revised set of tables relating to the inflation potential, including data on budget, debt, deficit, liquid assets, and national income.

Attachments

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TABLE I

FEDERAL BUDGET, WAR AND TRANSITION

Total Funds Raised

(in billions of dollars)

Period	From Taxes	From Borrowing 1/	Total	Taxes as Percentage of Total
Fiscal year ending June 30				
1940	5.4	2.5	7.9	68.4
1941	7.6	6.9	14.5	52.4
1942	12.8	21.8	34.6	37.0
1943	22.3	63.0	85.3	26.1
1944	44.1	61.6	105.7	41.7
1945	46.5	55.7	102.2	45.5
1946	38.6	16.1	54.7	70.6
1947	31.5	-3.6	27.9	112.9
1940-1946	177.3	227.6	404.9	43.8

1/ Change in interest-bearing debt, direct and guaranteed.

Note: "Total Funds Raised" is defined to include (1) net receipts, general and special accounts, and (2) the increase in total interest-bearing direct and guaranteed securities. Note that for any single year expenditures may fall short of or exceed funds raised, depending on changes in Treasury balances.

TABLE II

THE FEDERAL DEBT

Deficits from War and Depression

(in billions of dollars)

Period	Dates 1/	Interest-bearing Debt	
		Change During Period	Outstanding End of Period
World War I	1916-1919	+ 24.2	25.2
Reduction in 'Twenties	1919-1930	- 9.3	15.9
Early Depression	1930-1933	+ 5.5	21.4
Relief and Recovery	1933-1940	+ 26.5	47.9
World War II	1940-1945	+211.5	256.8
	1945-1946	+ 16.1	272.9
	1946-1947	- 3.6	269.3

1/ All figures apply to June 30 dates with the exception of 1930 which applies to March 31.

Note: All interest-bearing direct and guaranteed securities are included.

TABLE III

DEFICIT AND THE PUBLIC DEBT

(in billion dollars)

	Exp's	Net Receipts	Deficit	At End of Period	
				Public Debt 1/	Cash Balance
1940 Fiscal Year	9.0	5.4	3.9	43.0	1.9
1945 Fiscal Year	100.4	46.5	53.6	258.7	24.7
1946 Fiscal Year	67.3	38.6	28.6	275.0	11.9
July-Dec. 1945	38.8	19.9	18.1	278.1	26.0
Jan.-June 1946	28.5	18.7	10.5	275.0	11.9
1947	35.8	31.5	4.3	271.0	3.2

1/ Total gross direct debt.

TABLE IV (revised)

TOTAL PUBLIC AND PRIVATE GROSS DEBT 1/

(in billions of dollars)

Type of Debt	End of Calendar Years				
	1929	1933	1940	1944	1945*
Total	213	187	215	419	453
Public	35	45	74	260	298
Federal	18	25	54	242	281
State and Local	17	20	20	18	16
Private	178	142	141	159	155
Corporations	109	94	91	110	107
Other	69	48	50	49	48

1/ From "United States Debt Pattern in War and Peace" by Alvin Slater, Survey of Current Business, September 1945.

* Estimated.

Note: The table shows the gross debt, public and private. The figures for 1929 to 1940 are from Survey of Current Business, Department of Commerce, July 1944; figures for later years are estimated.

TABLE V

INFLATION POTENTIAL IN LIQUID ASSETS 1/

(in billions of dollars)

Type of Asset	June 30 1920	1929	1933	1940	1944	1945	Dec. 31 1945
Deposits							
Demand	18.6	21.4	13.2	22.8	47.8	56.3	61.4
Time	15.8	28.6	21.7	26.7	35.0	48.2	48.2
U. S. Gov't	0.3	0.4	0.8	0.8	19.5	24.4	24.6
Total	34.7	50.4	35.7	50.3	102.3	128.9	134.2
Currency	4.1	3.6	4.8	6.1	20.0	24.2	26.0
U. S. Securities	18.9	10.0	10.3	12.0	66.9	84.2	89.7
Grand Total	57.7	64.0	50.8	68.4	189.2	237.3	249.9

1/ Items other than U. S. government deposits include holdings by individuals, unincorporated businesses and corporations. The figures exclude (1) holdings by government trust funds, Federal Reserve Banks, commercial banks, mutual savings banks, foreign governments and foreign banks. They also exclude (2) holdings by insurance companies, building and loan associations, nonprofit associations, state and local governments, and foreign individuals. Total deposit and currency holdings of the groups listed under (2) amounted to 6.4 billion dollars on June 30, 1945. For more detailed breakdown see Federal Reserve Bulletin for February 1946, p. 123.

TABLE VI

LIQUID ASSET HOLDINGS BY TYPES OF HOLDERS 1/

(in billions of dollars)

	End of June 1940	End of Dec. 1945
Corporations		
Demand Deposits	10.7	27.3
Time Deposits	0.7	0.7
Currency	0.7	1.0
U. S. Securities	2.0	23.0
Total	14.1	52.0
Unincorporated Business		
Demand Deposits	3.3	10.5
Time Deposits	1.3	2.4
Currency	0.9	3.9
U. S. Securities	1.1	11.0
Total	6.6	27.8
Individuals and Trust Funds		
Demand Deposits	8.8	23.6
Time Deposits	24.7	45.1
Currency	4.5	21.1
U. S. Securities	8.9	55.7
Total	46.9	145.5
U. S. Government		
Demand Deposits	0.8	24.6
All Groups	68.4	249.9

1/ For explanation see note to Table V. For more detailed breakdown see Federal Reserve Bulletin for February 1946, p. 123.

TABLE VII

GROSS NATIONAL PRODUCT AND NATIONAL INCOME STATISTICS

(in billions of dollars)

	1944	1945 (seasonally adjusted annual rates) 1	2	3	4
GNP	197.6	204.5	206.3	195.7	182.8
Government purchases of goods and services	97.1	95.6	99.2	79.5	57.7
Federal	89.5	87.8	91.3	71.6	49.8
State and local	7.7	7.8	7.8	7.9	8.0
Consumers	98.5	105.0	100.0	103.7	110.9
Gross Capital formation	2.0	3.9	7.1	12.5	14.2
National income 1/	160.7	167.6	166.2	158.4	150.7
Salaries and wages	116.0	119.6	118.3	113.0	105.7
Agricultural proprietors	11.8	13.3	13.2	12.2	12.1
Non-agricultural proprietors	12.3	13.0	12.6	12.9	13.9
Interest and rents	10.6	11.4	11.7	11.9	12.2
Net corporate profits	9.9	10.4	10.4	8.4	6.8
Income payments 2/	156.8	163.7	163.2	158.6	156.9
Personal taxes	19.4	22.1	21.7	20.6	19.7
Disposable income	137.4	141.7	141.6	138.0	137.3
Consumer expenditures	98.5	105.0	100.0	103.7	110.9
Net savings	38.9	36.7	41.6	34.3	26.4

1/ National income equals the gross national product minus business taxes, depreciation and business reserves, and an adjustment for inventory revaluation.

2/ Income payments equals the national income (see footnote 1) plus transfer payments unemployment compensation, mustering-out pay, etc.) less contributions to social insurance funds and corporate savings.

February 18, 1946

Chairman Eccles

Richard A. Musgrave and
Kenneth B. Williams

Material for Testimony on

OPA Extension

Attached is material for your testimony on the extension of the Price Control Act, including:

(1) Draft of Testimony

(2) Background memo on proposed amendments, etc.

(3) Revised tables on Budget, debt, liquid assets, national income, etc.

(4) Copy of OPA materials, including:

(a) Chester Bowles' statement before the House Banking and Currency Committee presented today.

(b) OPA testimony before the House Banking and Currency Committee today.

(c) Charts submitted by Chester Bowles before the Senate Small Business Committee, December 1945.

Attachments

RAM:lt

Statement of Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, before the Banking and Currency Committee of the House of Representatives, February , 1946, on Extension of the Emergency Price Control Act of 1942.

I should like to begin by reading from my statement on the extension of price controls made before the Senate Banking and Currency Committee almost two years ago. At that time, I said:

> "Inflations seldom get out of hand during wartime, but the danger carries over after peace comes and a war-weary people, tired of wartime controls and restraints, are eager to throw them off. That is just the time when it may be fatal to relax prematurely the controls of war-engendered inflationary forces. That is why it is so important to extend the life of this legislation for a sufficient period after the war to enable the country to convert its enormous production capacity to turning out for peacetime consumption a supply of goods comparable to what it has shown itself capable of turning out for war purposes."

I also said then:

> "Inflationary pressures are still increasing, and will continue to increase until reconversion from

wartime production to peacetime production has been achieved and a balanced budget is in prospect. If the public is assured that the Congress is determined to contime this legislation which has been so effective, the great confidence which now exists in the purchasing power of the dollar will be maintained---without that confidence, not only would the successful prosecution of the war be jeopardized, but an orderly transition to a peacetime basis would be out of the question."

These statements of two years ago still hold, but in the meantime many of our inflation checks have been discarded while inflationary pressures have been augmented greatly.

The danger of inflation, in fact, was never so great during the war as it is today. Two years ago inflation pressures were sizeable but our defenses were strong. We had many checks and influences to ward off trouble, including direct controls over the allocation of materials, rationing, heavy excess profits taxes, strong wage controls, and by no means least, the compelling urge of patriotism which led the public to accept sacrifices and inevitable inequities without complaint. Today, most of these controls have been abandoned and the unifying force of participation in war is no longer operating.

Too many of our defenses against inflation already have been destroyed. Once gone, they are difficult to restore. These lost defenses include: the repeal of the excess profits tax; the abandonment of most allocation controls and rationing of practically all commodities; the failure to forestall the development of a "boom" psychology in real estate and security markets; and the early reduction in average hours of work before we had achieved the mass production of civilian peacetime output.

In the meantime, inflation pressures have continued to expand. Liquid assets in the hands of the public now exceed 225 billion and will rise further in the coming year as the remaining budget deficit will be financed by drawing on the Treasury's general balance. Currency and demand deposits held by businesses and individuals alone are nearly 80 billion, or almost 3 times the prewar level. Also, these groups hold 50 billion dollars of demand deposits and nearly 100 billion dollars of Government securities. The potential demand for consumers goods, plant and equipment, therefore, is not limited by current income or by available credit. It may be greatly augmented at any time by drawing on these balances. This situation, of course, is the result of war financing--the result of a policy which placed excessive reliance on borrowing and inadequate reliance on taxation. Thus, during the fiscal years from 1940 to 1946 the Treasury will have raised over 400 billion dollars, and more than 40 per cent of this will have come from borrowing. Of the total increase in the debt, the commercial banking system will have absorbed over 40 per cent.

In time, the vast expansion of liquid assets brought about by this policy may be a healthy factor in helping to sustain a high level of economic activity. But now--and until peacetime production has been resumed at a full scale and the brunt of delayed demand has been met--the vast store of liquid assets presents a serious threat to economic stability. It enormously increases the importance of maintaining a vigorous stabilization policy, including price controls and a determined effort to balance the budget. If these things are not done, if we permit the millions of individuals and businesses who hold currency, deposits, and securities to lose faith in the purchasing power of the dollar, we shall invite disaster.

I am not calling attention to these things because I like controls or want to see them continued indefinitely. On the contrary, all controls should be dropped as soon as it can be done safely. They must be retained, however, until the transition to a stable peacetime economy has been assured and supplies in most lines have become adequate to meet the demand. As yet, there are very few lines in which supplies are adequate to satisfy demand or are likely to be adequate soon. Offhand, I can hardly think of a single commodity in which the supply is adequate. Acute scarcities persist for most products.

Because we have scrapped nearly all of our other controls, it is double important that we maintain and strengthen our control of prices. If we had retained the excess profits tax, we could afford to operate price controls more leniently since the danger of inflationary spirals would be substantially less because incentives for raising prices would be checked by high taxes. Similarly, if we had retained more direction over the allocation of materials, price controls could have been operated more loosely since the danger of a serious distortion of supplies or diversion of goods into black markets could have been met by direct means. If we had continued longer hours of work, the critical issue of sharp advances in wage rates to maintain take-home pay could have been postponed until the peak of inflation pressure was passed and the job of price control would have been made simpler.

It has been argued that adequate supplies will be forthcoming only if price controls are dropped promptly. This is a dangerous fallacy. I fully subscribe to the premise that a flood of production is the only sure way to prevent inflation, but I see no assurance whatsoever that greater production will result from generally higher prices and costs. Of course, there are products here and there the supply of which would increase if their particular prices were raised. These cases can be handled best on an administrative basis and I am confident that under the new arrangement Mr. Bowles and Mr. Porter will make whatever adjustments are needed. I should like to urge that the Office of Price Administration be assured adequate facilities to handle justified demands promptly and without delay. The general need, however, is not for a loosening of price controls. Generaly higher prices will intensify the scramble for scarce materials, the accumulation of inventories, the holding of goods off the market in expectation of further price advances, the disorganization of production, and the failure to supply those goods which consumers need most. In the scramble for scarce materials and supplies, it is the small business in particular which is likely to lose out. As prices rise, industrial discontent and strife will be intensified and production may again be stalled as workers seek higher wages to meet their rising costs of living.

It is not true, in general, that production is being held back by price controls. Reconversion is proceeding faster than anyone expected. Instead of the high unemployment widely anticipated, the number unemployed remains below 2½ million. In spite of the large lay-offs in munitions industries, total non-agricultural employment by January had regained its pre-VJ Day level and is still increasing. The Federal Reserve index of industrial production was above its 1941 level until the steel strike and will soon surpass this level once the strike is settled. Income payments have declined only moderately and by summer may exceed the level reached at the peak of the war. Where production is being restricted, the usual cause is lack of manpower or materials and, more recently, industrial disputes which now appear in the process of settlement. Only in exceptional situations are low price ceilings to blame. Although there is much complaint about low prices, profits are large and it is not unlikely that profits after tax for 1946 will be the highest on record.

All this points to the necessity for maintaining our defenses against inflation. The most effective thing that can be done is for Congress to extend without amendment the present price control law for at least one year. The sooner this is done, the sooner businessmen will know how to plan ahead and the sooner goods will come out of hiding. It would be unthinkable to let price controls lapse or to cripple them with amendments. Doubtless the Act is not perfect and it might be improved by some amendments. However, once you open the door to meet the criticisms of one group, you cannot without difficulty close it to other groups. Every exception adds to the inflation spiral and creates pressure for other exceptions. Every price increase fosters expectations of other price increases.

Our primary need and our only sure means of escape from inflation is production. We must go to work, stop haggling over pennies, and have faith in our economic system. No single measure before Congress in my opinion carries with it the hopes and prayers of the American people as does the extension of price control legislation. Unless this law is extended promptly and for at least a year, I am fearful of the consequences in lost production, industrial strife, and inflation. Prompt passage of this measure will do more toward directing the country into a period of peacetime prosperity and full employment than anything else Congress or the Administration can do.